

17 April 2018

To,

**Shri S. Machendranathan**

**Chairperson**

**Airport Economic Regulatory Authority of India (AERA)**

**AERA Building, Administrative Block**

**Safdarjung Airport**

**New Delhi 110003**

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**Subject: User Development Fee (UDF) collection at Kemp Gowda International  
Airport (KIA), Bengaluru**

*Reference:*

- 1. AERA Order No. 08/2014-15 Determination of Aeronautical Tariffs in respect of Kempegowda International Airport (Earlier Bengaluru International Airport), Bengaluru, for the first Control Period (01.04.2011 to 31.03.2016) issued on 10<sup>th</sup> June 2014*
- 2. AERA order No. 12/2017-18 F. No./20019/CGF-G/2010-11/Vol VIII - Extension of Charges till 31st March 2018*

Dear Sir,

Greetings from Bangalore Political Action Committee (B.PAC)!

On behalf of citizens of Bengaluru, truly in perspective of passengers using KIA, we would like to submit the following petition in determining the User Development Fee (UDF) collected at Kemp Gowda International Airport (KIA), Bengaluru.

We would like to draw your attention to the fact that BPAC had previously submitted comments/observations on the consultation paper No.22/2013-14 which the Authority had examined and considered before passing the final AERA Order No. 08/2014-15 in the matter of Determination of Aeronautical Tariffs in respect of Kempegowda International Airport

(Earlier Bengaluru International Airport), Bengaluru, for the first Control Period (01.04.2011 to 31.03.2016).

We draw your attention to the following areas in this petition:

1. **Setting the context w.r.t. AERA order and KIA projections & performance**
2. **Analysis of Capacity utilisation, Capital Investment, Revenue, Profitability, Return on Equity, GVK stake sale, and lastly, UDF accountability**
3. **Our Prayer**

## 1. Context

### 1.1 KIAL's Revenue Performance

1. **Aero Revenue:** Aero revenue has grown at a CAGR of 22% from 2009 to 2017. The tariffs for these services are set for five-year periods and are fixed so as to yield a regulated 16% ROE. Further, the regulatory authority treats 30% of non-aero revenue as aero revenue.
2. **Non-aero Revenue:** Non-aero revenue has grown at a CAGR of 19% from 2009 to 2017 and is expected to grow substantially due to the substantial increase in passenger growth rates, the availability of additional space and the increasing propensity of passengers at the airport to make purchases.
3. **Real Estate Monetization:** KIAL has approximately 460 acres of land adjoining the airport that can be developed. All of this land is undeveloped except for a small piece on which KIAL has built a hotel, currently operated by the Taj hotel brand under a management contract. Bangalore's historical population areas are getting congested, so the city is expanding in the airport's direction. KIAL has anticipated a significant upside, over time, from monetization of this real estate.

### 1.2 KIAL's Capacity & Expansion plans

KIA's current passenger handling capacity per year is **20 million passengers per annum**. KIA plans to expand the capacity of the airport, including construction of second runway and an additional terminal building, and expanding the related infrastructure. Additional terminal building commenced in 2017 and will be constructed in two phases; the first phase will have the capacity to handle **25 million passengers per annum (estimated to be completed by**

2021), while the second phase of the project will add capacity for another 20 million passengers per annum. The combined capacity of the existing and additional terminal will be approximately 65 million passengers per annum.

### **1.3 AERA's Powers & Functions**

As defined in the AERA Act under Chapter III – Powers and Functions of the Authority, **One of the primary objectives and functions of AERA** as a statutory body is **to determine the tariffs including User Development Fees (UDF) taking into consideration** the following:

- Economic and viable operation of Airport
- The capital expenditure incurred and timely investment in improvement of airport facilities
- The service provided, its quality and other relevant factors
- Revenue received from services other than the aeronautical services
- The cost for improving efficiency

As per Section 13(2) of the Act, The Authority shall **determine the tariff once in five years** and may if so considered appropriate and **in public interest, amend, from time to time during the said period of five years, the tariff so determined.**

In this regard, another power & function of AERA is essential in determination of the above fees. **This is to monitor the set performance standards relating to KIAL's quality, continuity, and reliability of service.**

### **1.4 User Development Fee (UDF)**

As defined in the 2014 AERA order, KIAL was allowed to levy a User Development Fee (UDF) (Domestic and International) on embarking passenger for the provision of **passenger amenities, services and facilities and the UDF will be used for the development, management, maintenance, operation and expansion of the facilities at the Airport.**

The below table shows the AERA computed UDF for KIA effective July 2014

| Summary of UDF computed based on Authority's decisions, keeping charges other than UDF as per BIAL's tariff proposal (w.e.f 1st July 2014) |             |            |                          |  |                     |                     |                     |
|--|-------------|------------|--------------------------|--|---------------------|---------------------|---------------------|
| Type of Passenger  | Current UDF | PSF (FC)** | Total current Pax charge | Recomputed UDF Rates under Single Till and 40% Shared Revenue Till as per Authority* |                     |                     |                     |
|  |             |            |                          | 2014-15  |                     | 2015-16             |                     |
|  |             |            |                          | Single   | 40%                 | Single              | 40%                 |
| Domestic (Rs.)   | 231.4       | 77         | 308.4                    | 279.70<br>Say 280  | 341.98<br>Say 342   | 257.17<br>Say 257   | 306.47<br>Say 306   |
| International (Rs.)  | 952.3       | 77         | 1029.3                   | 1118.82<br>Say 1119  | 1367.92<br>Say 1368 | 1028.69<br>Say 1029 | 1225.88<br>Say 1226 |

\* Proposed UDF levy is w.e.f. 1st July 2014.  
\*\* FC – Facilitation Component of Passenger Service Fee. For recomputed UDF rates by the Authority, this component of Rs. 77 is included or merged into proposed UDF.

It is also to be noted that, in the AERA's final order under Decision No. 8. for Traffic Forecast states, The Authority decided **"To true up the traffic volume based on actual growth during the current Control Period (2011-2016) while determining aeronautical tariffs for the next control period."**

However, KIAL is currently operating with unchanged tariffs even after the completion of the first control period (2011-2016). **AERA has been passing interim orders allowing KIAL to continue to levy the tariffs** existing as on 31.03.2016 for the past **24 months into the Second Control period** (FY2016-17 to FY 2020-21).

Below table shows the UDF charges since 2013-14

| UDF Collection (INR) | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|----------------------|---------|---------|---------|---------|---------|
| Domestic Tariff      | 342     | 306     | 306     | 306     | 306     |
| International Tariff | 1,368   | 1,226   | 1,226   | 1,226   | 1,226   |

### **1.5 KIAL's Passenger Traffic**

The below table compares and contrasts the projected and actual passenger traffic data at KIA since 2013-14

| Nos.            | 2013-14     | 2014-15     | 2015-16     | 2016-17     | 2017-18 (Est) |
|-----------------|-------------|-------------|-------------|-------------|---------------|
| Projected Total | 1,29,30,000 | 1,43,70,000 | 1,60,00,000 | 1,77,60,000 | 1,97,13,600   |
| Actual Total    | 1,28,60,000 | 1,54,01,926 | 1,89,71,290 | 2,28,81,410 | 2,58,33,112   |

### **1.6 Passenger Traffic has increased tremendously**

According to IATA (International Air Transport Association), India's domestic air passenger demand surged **22.9 percent in February, more than two-fold of the global average**, propelled by the launch of new flights and routes by the local airlines during the period.

February was also the **42nd month of double-digit year-on-year growth** on a trot, with a record more than 90 percent occupancy on aircraft operated by the domestic airlines.

The **domestic capacity (addition of aircraft in the fleet) climbed 7 percent** during the month while the **seat factor, increased by 0.9 percent to 82.3 percent** in the month, as per IATA monthly traffic data.

## **2. Analysis**

B.PAC undertook the below analysis of KIA Capacity utilisation, Capital Investment, Revenue, Profitability, Return on Equity, GVK stake sale, and lastly, UDF accountability since AERA has not released a consultation paper or held a public consultation, allowing KIA to levy tariffs in an unaccountable manner since 2016.

### **2.1 Capacity over utilization has led to congestion at KIA**

As per Fairfax's Annual Report, it is estimated that KIA will handle passenger traffic of **~26Mn in FY2018**. With a **capacity of merely 20Mn**, the airport is currently operating at an **overutilization rate of 130%**. In its 2017 credit review of KIAL's instruments, ICRA noted that the passenger throughput had exceeded the terminal capacity leading to **capacity constraints during peak hours**. This is clearly visible at the airport today and the passengers are already feeling the brunt, with the Airport clogged right from 6am.

Further, the airport will be in **no position to increase its capacity** until the completion of the first phase of the new terminal building in **2021 which will increase capacity to 45Mn**.

### **2.2 KIAL's capital utilisation focus has been on increasing flights, not capacity**

On August 16, 2017 KIAL completed the expansion of the existing terminal to support the immediate growth in passenger traffic, which included two new Rapid Exit Taxiways that **increased runway capacity**. With the addition of the two RETs, the Air Traffic Movements

(ATM) per hour capacity immediately increased from 34 ATMs per hour to 38 ATMs per hour and will progressively increase to 44 ATMs per hour.

This increase will be in addition to KIAL's already **substantial deviation from the ATM** projections made in 2014, as detailed below:

| <b>Air Traffic Movements (Nos.)</b> |                 |                 |                 |                 |                 |
|-------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| <b>Projections as per Order</b>     | <b>FY 12-13</b> | <b>FY 13-14</b> | <b>FY 14-15</b> | <b>FY 15-16</b> | <b>FY 16-17</b> |
| Domestic                            |                 | 94,621          | 1,05,748        | 1,17,381        | 1,30,292        |
| International                       |                 | 20,036          | 22,395          | 24,858          | 27,593          |
| <b>Total</b>                        |                 | <b>1,14,657</b> | <b>1,28,143</b> | <b>1,42,239</b> | <b>1,57,885</b> |
| <b>Actuals</b>                      |                 |                 |                 |                 |                 |
| Domestic                            | 86,848          | 97,854          | 1,10,754        | 1,26,947        | 1,46,989        |
| International                       | 18,340          | 20,721          | 23,455          | 26,884          | 31,128          |
| <b>Total</b>                        | <b>1,05,188</b> | <b>1,18,575</b> | <b>1,34,209</b> | <b>1,53,831</b> | <b>1,78,117</b> |
| <b>Difference (Nos.)</b>            |                 | <b>3,918</b>    | <b>6,066</b>    | <b>11,592</b>   | <b>20,232</b>   |

### 2.3 KIAL's Profitability & ROE is abnormal

Backed by very healthy growth in passenger traffic and increasing Non-Aeronautical revenues, KIAL has been extremely profitable since 2014. Their **Revenue from Operations** grew **2X** from 2014 to 2017 while the costs only increased by 1.46X. As shown in the below table, KIAL has grossed **45% Profit After Tax (PAT) Margins** for the current year and an incredible **49% ROE** for FY 16-17.

| <i>(INR Cr)</i>         | <b>FY 2013-14</b> | <b>FY 2014-15</b> | <b>FY 2015-16</b> | <b>FY 2016-17</b> | <b>Jan-Dec 2018</b> |
|-------------------------|-------------------|-------------------|-------------------|-------------------|---------------------|
| Revenue from Operations | 646.44            | 915.51            | 1,137.97          | 1,314.35          | 1,501.50            |
| Total Expenses          | 261.1             | 313.91            | 334.39            | 382.81            |                     |
| EBIDTA                  | 385.34            | 601.6             | 803.58            | 931.54            |                     |
| EBITDA Margin           | <b>60%</b>        | <b>66%</b>        | <b>71%</b>        | <b>71%</b>        |                     |
| PAT                     | 67.38             | 75.31             | 419.06            | 565.38            | 682.50              |
| PAT Margin              | <b>10%</b>        | <b>8%</b>         | <b>36%</b>        | <b>42%</b>        | <b>45%</b>          |
| Share capital           | 384.6             | 384.6             | 384.6             | 384.6             |                     |
| Reserves and surplus    | 391.99            | 402.54            | 820.76            | 1338.72           |                     |
| (Less) PAT              | 67.11             | 75.31             | 419.06            | 565.35            |                     |
| Total Shareholder funds | 709.48            | 711.83            | 786.3             | 1157.97           |                     |
| ROE                     | <b>9%</b>         | <b>11%</b>        | <b>53%</b>        | <b>49%</b>        |                     |

Clearly, the economics of the Concession Agreement have by themselves been appealing for KIAL. Additionally, the **undetermined returns from related land transactions are an intangible**, which can provide KIAL significant upside. AERA not taking this upside into consideration further allows for KIAL to go unaccounted for its abnormal profits.

#### **2.4 Abnormal profitability has allowed GVK to divest at a very high valuation**

BPAC has outlined the events leading up to GVK's recent divestment from KIAL. The most recent divestment which allowed Fairfax to get 6 board members has **valued KIAL at INR 12,900 Cr, a sign of its extraordinary lucrativeness for the incoming investor.**

| Event             | Stake | FY   | GVK Cashflow (INR Cr) | Total        | Valuation (INR Cr) |
|-------------------|-------|------|-----------------------|--------------|--------------------|
| Zurich to GVK     | 12%   | 2010 | -485                  | -1,784       | 4,038              |
| L&T to GVK        | 17%   | 2010 | -686                  |              | 4,035              |
| Siemens to GVK    | 14%   | 2012 | -614                  |              | 4,384              |
| GVK to Fairfax    | 33%   | 2017 | 2,202                 | 3,492        | 6,673              |
| GVK to Fairfax    | 10%   | 2017 | 1,290                 |              | 12,900             |
| <b>GVK Profit</b> |       |      |                       | <b>1,708</b> |                    |

#### **2.5 Abnormal profitability is UDF-subsidized**

AERA has not tried up UDF revenue considering the traffic volume based on actual growth during the 2011-2016 control period while determining aeronautical tariffs for the 2016-2021 control period. AERA has allowed KIAL to keep charging passengers UDF at the same rate as was determined in the last order, without considering:

- passenger traffic has swelled beyond projections, delivering bountiful returns to KIAL
- no increase in capacity and no projected increase until 2021, forcing passengers to cramp up in the airport

**In not abiding by its own Order, AERA has failed in its duty of tariff regulation.** Based on past projections and actuals, BPAC has summarised that an unprojected **UDF-driven income of INR 379.79 Cr has not been tried up** since 2013-14 as shown in the table.

| <b>Projected Traffic</b>    | <b>2013-14</b>      | <b>2014-15</b>      | <b>2015-16</b>      | <b>2016-17</b>        | <b>2017-18 (Est)</b>  |
|-----------------------------|---------------------|---------------------|---------------------|-----------------------|-----------------------|
| Domestic                    | 1,03,00,000         | 1,14,00,000         | 1,26,60,000         | 1,40,52,600           | 1,55,98,386           |
| International               | 26,30,000           | 29,70,000           | 33,40,000           | 37,07,400             | 41,15,214             |
| <b>TOTAL</b>                | <b>1,29,30,000</b>  | <b>1,43,70,000</b>  | <b>1,60,00,000</b>  | <b>1,77,60,000</b>    | <b>1,97,13,600</b>    |
| Est growth as per KIAL      |                     | 11%                 | 11%                 | 11%                   | 11%                   |
|                             |                     |                     |                     |                       |                       |
| <b>Actual Traffic</b>       |                     |                     |                     |                       |                       |
| Domestic                    | 1,02,30,000         | 1,21,86,774         | 1,50,11,033         | 1,81,04,916           | 2,04,40,450           |
| International               | 26,30,000           | 32,15,152           | 39,60,257           | 47,76,494             | 53,92,662             |
| <b>TOTAL</b>                | <b>1,28,60,000</b>  | <b>1,54,01,926</b>  | <b>1,89,71,290</b>  | <b>2,28,81,410</b>    | <b>2,58,33,112</b>    |
| Traffic Growth              | 20.9%               | 19.8%               | 23.2%               | 20.6%                 | 12.9%                 |
|                             |                     |                     |                     |                       |                       |
| <b>UDF Collection (INR)</b> | <b>2013-14</b>      | <b>2014-15</b>      | <b>2015-16</b>      | <b>2016-17</b>        | <b>2017-18 (Est)</b>  |
| Domestic Tariff             | 342                 | 306                 | 306                 | 306                   | 306                   |
| International Tariff        | 1,368               | 1,226               | 1,226               | 1,226                 | 1,226                 |
| Arrival:Departure Ratio     | 0.5                 | 0.5                 | 0.5                 | 0.5                   | 0.5                   |
| UDF Projected               | 3,56,02,20,000      | 3,56,48,10,000      | 3,98,44,00,000      | 4,42,26,84,000        | 4,90,91,79,240        |
| UDF Actuals                 | 3,54,82,50,000      | 3,83,54,64,622      | 4,72,43,25,492      | 5,69,80,43,125        | 6,43,30,90,688        |
| <b>Difference</b>           | <b>-1,19,70,000</b> | <b>27,06,54,622</b> | <b>73,99,25,492</b> | <b>1,27,53,59,125</b> | <b>1,52,39,11,448</b> |

The above calculations have been made in the absence of adequate details in KIAL's AR considering the following assumptions:

- International vs. Domestic passenger traffic has been retained as per original estimate of 20.875% for FY 2014-15 and onwards.
- Proj. traffic for FY 2016-17 has been grown at a rate of 11% as was used for 2014-16.
- Arrival vs. Departure ratio maintained at 50% as per KIAL's original MYTP submission from Feb 2012.
- FY2018 numbers are estimated based on Fairfax Annual Report, 2017.

## **2.6 Summary of the Analysis**

Through the above analysis, BPAC has determined that **KIAL has not considered the "User Development" aspect of the User Development Fee** in letter and spirit.

- Passengers are already suffocated by the capacity overutilization at KIA and will have no option but to be further inconvenienced during the following years.
- UDF has subsidised KIAL at the cost of users, created abnormal monopoly profits.
- Failing to reduce KIAL's abnormal profits, AERA has allowed the previous investor to exit at a large premium.



### 3. Our Prayer

We submit the below prayers for safeguarding the interests of Bengaluru's passengers -

- We urge AERA to **true up the revenue earned from the deviation in passenger traffic to the tune of INR 379.79 Cr.**
- We urge AERA to **summarily nullify the UDF from 1<sup>st</sup> May 2018 as passengers should not be forced to pay a development fee when the Airport is earning huge monopoly profit and user fees are beyond projection.**
- We urge AERA to **strictly audit, monitor, and report KIAL's utilisation of funds received through UDF and disallow expenditures/investments that increase non-aero revenue.**
- We urge AERA to **follow the due public consultation process while determining tariffs and AERA should release the public consultation paper immediately** and follow the set process in determining tariffs in a time-bound manner.

Looking forward for a judicious decision from your good office, resulting in passenger protection while determining KIA's tariffs.

Thanking you,

Yours faithfully

-Sd-

Revathy Ashok  
Hon Managing Trustee & Chief Executive Officer

CC:

Shri. Shankar Narayanaswamy, Member, AERA  
Shri. Subrata Samanta, Member, AERA  
Shri. Vijay Kumar Sachdeva, DGM (Fin.), Regulation & Tariff Fixation  
Shri. Satish Sachdev, Under Secretary (P&A)